

**Department of the Treasury**  
**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations: Examinations  
1100 Commerce Street, MC 4920 DAL  
Dallas, Texas 75242

Number: **201252029**  
Release Date: 12/28/2012

**DATE: August 15, 2012**

ORG  
ADDRESS

501.04-00

**Taxpayer Identification Number:**

**Form:**

**Filing period(s) ended:**

**Person to contact / ID number:**

**Contact Numbers:**

Phone:

Fax:

**Manager's name/ID number:**

**Manager's contact number:**

Phone:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated January 11, 20XX, you were held to be exempt from Federal income tax under Section 501(c)(4) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of Section 501(c)(4) of the Code. Accordingly, your exemption from federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under Section 501(c)(4) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On March 19, 20XX, you signed a Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under Section 501(c)(4) of the Code.

You are therefore required to file Form 1120, *U.S. Corporation Income Tax Return*, or Form 1120-H, *U.S. Income Tax Return for Homeowners Associations*, if qualified, for the year ending December 31, 20XX, with the Ogden Service Center. For future periods, you are required to file Form 1120 or 1120-H with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax

determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channel gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosure:  
Reports of examination

ORG

EIN: EIN

Form 1024, Part n- Activities and Operational Information

LEGEND

ORG - Organization name      EIN - EIN      County - county      State -  
state      City - city      CO-1, CO-2, CO-3 & CO-4 - 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup> & 4<sup>th</sup>  
COMPANIES

*Overview*

The ORG ("Foundation") is a homeowner's association charged with the sole obligation to maintain the common areas, streets, sidewalks and other facilities commonly available to residents who are members of the Foundation.

CO-1 is a planned community in County, State located within the City of City, State. City is an incorporated city in County, State. Within the CO-1 community, there are about 12,736 housing units which house approximately 16,500 residents. These residents are members of the Foundation. Also, there are approximately 1,435 additional residents in CO-1 who are neither homeowners or members of the Foundation. The total residents within the CO-1 housing units represents % of the total residents of the City of City.

The real property contained in the development consists of 2,095 acres. Of that amount, 1706 are owned by the individual members. 389 acres are owned by the Foundation and include:

- 175 Green acres and park land
- 3 Lawn bowling greens
- 6 club houses
- Equestrian rink
- 40 Horse stables (stalls)
- 10 Tennis courts
- 5 Swimming pools
- 2 golf courses

The acreage owned by the Foundation combined with the acres owned by individual residents of CO-1 comprise approximately % of the total acreage within the City of City, County, State. The remaining balance is comprised of other real property and residents who are not affiliated with the Foundation or CO-1.

The Foundation is subject to the provisions of the State Nonprofit Corporate Law and, as a homeowner's association, is further subject to the State Civil Code Section 1350 et seq. Under these civil code sections and, at section 1364, the Foundation is responsible for repairing, replacing or maintaining the common areas, other than exclusive use common areas, and the owners of each separate interest is responsible for maintaining that separate interest and any exclusive use common area appurtenant to the separate interest.

Under State law, a homeowner's association may not be relieved of this statutory duty to maintain and repair common areas through a contractual provision.

Additionally, under section 1365.5, the board of directors of the Foundation must review on a quarterly basis the actual reserve revenues and expenses of the current year compared to current year's budget. The Foundation Board of Directors must exercise prudent fiscal management in maintaining the integrity of the reserve account. Finally, once every 3 years the Board of Directors must conduct a reasonably diligent inspection and must review the study annually to consider and implement necessary adjustments to the Board's analysis of the reserve account requirements.

### *Tax Rulings*

The Internal Revenue Service has stated in Revenue Ruling 74-99, 1974-1 C.B. 131 that in order for a homeowners association to be eligible for tax exemption under section 501 (c)(4), it:

- must serve a community that bears a reasonably recognizable relationship to an area ordinarily identified as governmental.
- must not conduct activities directed to the exterior maintenance of private residences, and
- the common areas and facilities it owns and maintains must be for the use and enjoyment of the general public.

The Foundation serves a community that bears a reasonable relationship to an area normally identified as a governmental unit. Additionally, the Foundation is solely obligated to maintain common areas and facilities. It cannot and does not conduct any activities directed to the maintenance of the exterior of private residences.

#### *1. Services to A Community that Bears a Recognizable Relationship to a Governmental area.*

As related above, the area served by the Foundation comprises approximately % of the residents of the City of City and % of the total real property in the City of City. The Foundation provides for the health, safety and welfare of its members and nonmembers in a variety of ways. In so doing, the Foundation provides services which would otherwise be undertaken by the City of City. By taking on these "municipal-type" services, the Foundation lessens the burden on the City of City to provide for such services.

#### *A. Police*

The Foundation provides quasi-police services for the entire 18,000 population of the CO-1 community, which constitutes approximately (%) of the total population of the City of City. There is a police patrol which provides security by patrolling the community on a 24-hours-a-day basis. This important police function is the only 24-hours service provided within the City of City. This patrol handles all parking,

speeding, failure to stop, and failure to yield issues within the community. This patrol also responds to any and all daytime or nighttime calls regarding emergency or other problematic situations.

This police patrol responds to all calls on a 24-hours-a-day basis and will refer a call to the Police Department of the City of City if criminal activity is involved.

Indeed, the Foundation police patrol engages in all manner of security activities based on a sizable written standard operating procedures manual. The security forces are primarily staffed with former or retired municipal police officers and others with traditional law enforcement experience.

The police operation of the Foundation applies to % of the residents of the City of City. The annual cost of the police operation undertaken by the Foundation is \$. This marks a substantial effort of the Foundation which lessens the burden of the City of City required to provide such security. See Revenue Ruling 74246, 1974-1 c.B. 130 (organization that assist the police in apprehending criminals is exempt as a charitable organization).

#### B. Library

The Foundation provides a full service library. The average annual number of visits to the library is 61,000. The City of City does not have a library. County does operate a library system, but there is no branch in the City.

The library is staffed by unpaid volunteers drawn from the community served by the Foundation. Average annual costs to operate the library are \$. The Foundation pays all costs for this facility. In doing so, it lessens the burdens on the City of City to provide a library for use by % of its residents.

#### c. Churches

There are eight churches that regularly meet within the Foundation facilities with a collective congregation of over 1,325. Approximately 105 members of the various congregations are not residents of CO-1.

#### D. Streets and Sidewalks

The Foundation owns, repairs and maintains approximately 18.5 miles of streets and sidewalks - over % of the streets and sidewalks in the City of City. It has sole and complete responsibility for this function. The total cost to repair and maintain the streets and sidewalks is approximately \$ per year. Again, by undertaking this function at its own expense the Foundation lessens the burden on the City of City to do so.

#### E. Waste Collection

The Foundation provides waste collection through a contract with a private waste collection company. The annual cost for this service is \$. This activity and the associated burdens undertaken by the Foundation lessen the burdens of government on the City of City relative to % of the residents of the City of City.

#### F. Bus Service

Total annual usage is 615,000 rides at an operating cost of almost \$ year. Capital investment in equipment is almost \$.

Buses operate 7 days a week, 12-16 hours a day. Most of them are fixed routes that cover all of City and part of ORG. In the evenings, the buses operate on a "demand-response" basis and offer door-to-door service.

There is also a specially equipped bus with specially trained drivers that operates on demand (by appointment) for severely handicapped people who need extra assistance boarding. This bus replaced a service (Dial-a-Ride) that was previously operated by County which charged a nominal \$ fee and was discontinued in 19XX.

In rendering this service, the Foundation lessens the burdens on the City of City to provide the service for % of the residents of the City of City. And with regard to the specially equipped bus, the Foundation has undertaken a burden previously undertaken by a governmental unit - County, State – which discontinued the service due to budgetary constraints.

Discussions are currently in process between the Foundation and the City of City with regard to allowing additional public use of the Foundation buses under a subsidy arrangement with the City. See Revenue Ruling 78-69, 1978-1 C.B. 156 (organization that operated bus service during rush hour is exempt as a social welfare organization).

#### G. Water Quality Testing

There are two creeks in the City of City that feed into public waters. Creek drains into the Pacific Ocean south of the city of City. Creek drains into the Bay.

#### 4 Exhibit A

There are limitations on the amount of various pollutants that each jurisdiction can add to water as it flows over their property. Independent testing of the water quality is performed to monitor the pollution levels so that corrective measures can be taken to clean up the water, or so that it can be proven that the particular jurisdiction in question is not responsible for upstream pollutants.

The Foundation undertakes all of the testing required of the City of City to comply with this environmental standard. The Foundation pays all of costs for this effort. The total annual costs are over \$. In undertaking this effort, the Foundation lessens the burden on

the City of City to provide this testing. See Revenue Ruling 70-186, 1970-1 C.B. 127 (organization treating lake water for recreational use is exempt as a charitable organization).

## II. Common Area Maintenance

The Foundation maintains the common areas and facilities used by its members. It is required by State law to do so. It provides no services or benefits to the private residences owned by its members.

## III. Access to Common Areas and Facilities

Additionally, the Foundation welcomes non-residents and nonmembers to its common areas and facilities as set out below:

### A. Swimming Pools

The Foundation owns, operates and maintains 5 swimming pools for the benefit of the community. See Revenue Ruling 50-310, 1959 C.B. 146. Annual swimming pools visits are approximately 126,400. Of that total approximately 16,185 (%) are individuals (including children) who are members of the public and not members of the Foundation.

### B. Golf Courses

Total annual number of rounds of golf on the 2 golf courses maintained by the Foundation are approximately 166,000. Of that total approximately 28,460 ( %) rounds of golf are played by individuals who members of the public and are not members of the Foundation.

Additionally, there are 8 annual golf tournaments sponsored by a variety of public organizations such as                      Hospital and                      County Seniors. The total golfers in these tournaments are 1020 of which approximately 585 are members of the public and not members of the Foundation.

### C. Stables

Total average annual rides are 36,850. Of that total approximately 13,712 (%) are rides by individuals (including children) who are members of the public and not members of the Foundation and who enjoy the annual Easter Egg Hunt, 3 annual horse shows and the 5 Bar - B - Qs hosted by the CO-2 annually.

### D. Lawn Bowling

Average annual lawn bowling participation is 11,600. Of that amount, approximately 1,340 are individuals who are members of the public and are not members of the Foundation. Additionally in 20    , the CO-3 will be held at City. This tournament will

have approximately 400 individual bowlers of which 250 will be members of the public and who are not members of the Foundation. Additionally, a further number of guests of the nonmembers (estimated at 100) will be present during the tournament.

#### E. Clubs and Organizations

There are 240 clubs and organizations in City with total membership of approximately 24,000. Of that total, approximately 3,120 (%) are members of the public and not members of the Foundation.

#### F. Private Gatherings

Community facilities are regularly used for private gatherings such as weddings, birthday parties, anniversaries, and family gatherings. The average annual attendance at all such gatherings is approximately 37,000. Of that amount about 30,000 (%) are members of the public and not members of the Foundation.

#### G. Community College Classes

CO-4 offers over 100 classes in City - all of which are open to non-residents. The total annual participation is about 7,500 of which 900 (%) are members of the public and not members of the Foundation.

#### Visitors

In addition, year over 16,000 non-residents visit the facilities with no limitation on their activities. Each such individual obtains a guest pass.

The Foundation, its facilities and its activities are coextensive with the City of City, State. The Foundation provides facilities and services to % of the residents of the City of City. See *Rancho Santa Fe Association v. U.S.*, 84-2 USTC (US D. Ct, So. Dist. Calif. 1984); Revenue Ruling 80-63, 1980-1 C.B. 116.

Beyond providing services and facilities for the benefit of its members, individuals who are not members of the CO-1 Community also participate in such benefits. The Foundation respectfully submits that it meets the requirements of Revenue Ruling 74-99 because:

- The Foundation serves a community of approximately 18,000 people which comprises approximately % of the population of the City of City. The Foundation provides services to the community which are municipal-like services. Thus, this community clearly bears a reasonable relationship to an area ordinarily identified as governmental.
- The Foundation solely maintains common areas and facilities enjoyed by its members. It provides no benefit to the exterior of private residence owned by its members.



- The common area and facilities owned and maintained by the Foundation are annually accessed by over 100,000 individuals who are members of the public and not members of the Foundation or residents of the community.

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>		Schedule number or exhibit
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended	
ORG	EIN	December 31, 20XX	

**LEGEND**

ORG - Organization name      XX - Date      EIN - EIN      City - city      State - state  
 Agent - agent      CO-1. co-2. co-3. co-4 & co-5 - 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup> & 5<sup>th</sup> COMPANIES

**ISSUE**

Whether ORG constitutes a community within the meaning of Revenue Ruling 80-63.

Whether ORG continues to qualify as a social welfare organization described in the Internal Revenue Code §501(c)(4) and the regulations thereunder.

**FACTS**

**Organizational Information:**

ORG ("ORG") was incorporated on November 19, 19XX, in the State of State. ORG restated its articles and changed its name to the current name on November 14, 20XX. Purposes stated in these Articles of Incorporation are:

- "a. To act as Trustee of ORG Trust and any other trust incidental to any of these purposes.*
- b. To provide services and community facilities to the members of this Corporation and to their memberships.*
- c. To act as a partner and joint venturer, and to enter into co-partnership and joint venture agreements with other corporations and individuals.*
- d. To engage in any business or activity now or hereafter permitted under the Nonprofit Mutual Benefit Corporation Law of the State of State.*
- e. To sponsor and form State corporations, whose joint purpose will be to develop the community of CO-1."*

ORG filed Forms 1120-H, *U.S. Income Tax Return for Homeowners Associations*, throughout the years prior to receiving exempt status under the Internal Revenue Code ("IRC" or "the Code") §501(c)(4).

ORG submitted a Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, to the Internal Revenue Service ("the Service") on November 22, 20XX requesting to be exempt under the Code §501(c)(4). ORG described its operation in detail. See Attachment A for a copy of the Exhibit A attached to the Form 1024.

ORG answered "yes" to the question "*If the organization is claiming exemption as a homeowners' association, is access to any property or facilities it owns or maintains restricted in any way?*" within

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the Form 1024, Schedule B and added the explanation "*The facilities are open to the public. The taxpayer requests that all visitors sign in with the security office and that the visitor is sponsored by a member.*"

The Service granted ORG its exempt status under §501(c)(4) of the Code on January 11, 20XX without questioning statements made within the application.

### **Operational Information:**

The Service initiated a review of the Form 990, *Return of Organization Exempt From Income Tax*, Form 990-T, *Exempt Organization Business Income Tax Return*, and activities of ORG for the year ending December 31, 20XX.

ORG is comprised of at least five separately gated areas. These five gated areas are separated by the two main roads that cut through the city: Parkway going through North and South, Road going through East and West, and Avenue. going through East and West. ORG has 16 gates. Most of them have security guards inspecting/questioning every passing vehicle. Gates without security guards can only be accessed with keys or key cards.

Housing units within ORG represent % of real properties within the City. The remaining % are churches and commercial businesses located along the two main roads and outside of the gated areas. A post office is the only commercial facility behind the gated areas and is opened at the request of ORG and for the convenience of its resident-members.

The acreage owned by ORG and resident-members comprises approximately % of the total acreage of the city. Majority of the remaining % acreage is located outside of the gated areas.

ORG states in the application that its facilities and services are available to the general public and supports its statement with various visitation data, which indicated about % non-member use of all facilities.

### **Access to Facilities**

Access to most common areas and facilities are strictly controlled. A visitor must present a member, student or guest pass to have access to a common area or facility. The Recreation Division Policy spells out rules placed on resident-members. Under "Use of ORG Recreation Facilities" the policy states:

- "A. ... uses are for CO-2 residents and their guests only. ...
- C. ***An employee may not use a ORG facility or attend any function or event at any ORG Recreational Facility except as an invited guest of a resident or if approval is granted by the ORG Board of Directors ...***

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- D. ... lease ... tenant(s) shall be entitled to the use of all of the ORG facilities or services as aforesaid during the term of said lease and the owner(s) shall not be entitled to such use ...*
- E. Guests must always be accompanied by a resident. Exceptions are noted in policy for the specific activity. Guests may not enroll in Recreation Division coordinated classes except those requiring a partner and the resident's partner is not a resident. Guests are not allowed to use any of the Clubhouse Four workshops. Where guests are permitted guests must pay applicable guest fees." [Emphasis added.]*

The Recreation Division Policy spells out rules by each facility or type of activity. Most of them clearly state restrictions placed on guests. However, hardly any one of them indicates how non-residents who are not students or guests can use or participate. For example, rules for Billiards, Bocce, PC Workshop, Horseshoes, Lawn Bowling, Paddle Tennis, Shuffleboard Courts, Table Tennis, Tennis and Video Lab at Clubhouse Two contain a statement similar to "[a]ll residents and guests must sign in upon arrival at the facility. ... Residents must accompany guests." Some of the facilities or activities have additional requirements as described below:

*Aquatics – "Residents must show their CO-2 picture identification card to the Lifeguard upon entering the pool area. Residents must accompany their guests to the pool and sign them in with the Lifeguard, but they are not required to stay with their adult guests. ... not more than five guests per resident at any one time."*

*Bridge Room – "Guests must arrive at and enter the Bridge Room with their sponsoring resident ..."*

*Equestrian Center – "Residents who have adult guests (age 18 or older) wishing to ride must accompany their guests to the Equestrian Center and register them. In addition, the Equestrian Center Supervisor must provide the guest with authorization to ride. ... Children must be 10 years of age or older to use ORG owned horses or to take lessons. A CO-2 resident must sign the minor guest in at the facility."*

*Fitness – "Residents must accompany their guests to the Fitness Centers and sign them in. ... Guests may be denied use of any exercise equipment if residents are waiting. ... Non-resident CO-4 students may use the Equipment Rooms in accordance with Recreation Division Policy Par I Section XI. ... Under the Fitness Center Pass Program, requests for guests to use the Equipment Rooms without being accompanied by a resident [for two weeks] will be evaluated on a case-by-case basis. The resident must complete the required application form and submit it to the Recreation Division with a letter from the resident's doctor attesting to the resident's inability to accompany someone to a Fitness Center Equipment Room, or documentation identifying the guest as the executor of the estate."*

*Golf Courses – "The Golf Courses are available only to residents and their guests. ... Non-residents may take lessons when accompanied by a resident."*

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Gymnasium – *“A resident may sponsor a maximum of two guests at any one time and must at all times accompany the guest(s).”*

Library – *“Residents are assessed fines on all over due materials that are checked out to them.”*  
Non-member or guest usage of the Library is not mentioned.

### **Non-resident Access to Facilities**

Clubs with non-resident-club-members:

Many residents form clubs of their own. A club with non-resident members is required to obtain *“gate clearance through process defined by Community Access for occasional non-resident members or guests”* for its non-resident members to access ORG facilities.

ORG changed requirements for non-resident-club-member access in 20XX and posted the following information on its website:

*“In response to a growing concern expressed by Board and resident members regarding who is permitted to enter into the Community, and for the purpose of being able to identify visitors who attend events for which a flyer will provide gate access, the ORG Board has enacted a policy for access for non-residents attending events for which a flyer is presented at the gate for entry.*

*Currently, a resident organizer of an event can request access for non-residents to the event by submitting a Gate Clearance Form at least 4 business days in advance to Community Access with a list of all non-resident guest names included on the form. The names of the guests are entered into the Gate Clearance System in order for the gate ambassador to permit access upon arrival of the guests.*

*Alternatively, the organizer of an event can submit a flyer to Community Access for approval, using the Gate Clearance Form, in order to avoid having to list all the names of potential non-resident guests. The approved flyer could then be shown to the Gate Ambassador by a non-resident to gain access into the community for the event. Until now, this clearance did not include that non-residents identify themselves.*

*ORG has approved a tear-off section that must be included on all flyers in order for a non-resident guest to enter into the Community (see below). **The flyer still must be approved by Community Access 4 business days prior to the event.** The Gate Ambassador will receive the completed tear-off portion of the flyer from the non-resident guest in order to permit gate access.”*

Each flyer is required to have the following section at the bottom:

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The following information is required to be detached and presented to the Gate Ambassador to gain access to the Community for this event.

<b>Event Information:</b>			
Event Type	Sponsor		
Day of Week	Date	Time	Location
<b>Visitor Information:</b>			
Name	Driver's License #		
Make/Model Auto	License Plate #		

#### Non-resident and guest fees:

Non-resident and guest fees are listed for Aquatics, Clubhouse Five for Saturday night dance, Clubhouse Seven for Bridge Room, Equestrian Center, Fitness Center, and Golf Course. Most fees are three to six times that of resident's fees. Fines for failure to return library materials are not listed for non-residents or guests.

#### Pool Privilege Pass for Guest:

- "1. ... request for guests to use the pool facilities without being accompanied by a resident will be evaluated on a case-by-case basis. The resident must complete the required application form and submit it to the Recreation Division with a letter from the resident's doctor attesting to the resident's inability to accompany someone to a pool facility, or documentation identifying the guest as the executor of the estate.
2. If ... issued ... **The pass has the guest's name, the manor number, the pool number for which the pass was issued, and the expiration date (not to exceed two weeks from date of issue).**
4. The pass **may be renewed in two-week increments** at the discretion of the Recreation Division.
7. **If a pass is misused in any way, it will be confiscated by the Lifeguard and returned to the Recreation Director. The resident ... may be referred for disciplinary action. A resident is responsible for the actions of his/her guest.** [Emphasis added.]

#### Private parties:

Private parties can be held at any of the seven clubhouses. If a private party is for non-resident wedding, the wedding has to be for a parent, a child or a grandchild of a resident only.

#### Shows and movies:

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Clubhouse Three has an auditorium that provides shows or movies; the only activity expressly permits employees to participate. The rules state *"Employees are permitted to purchase tickets for themselves and their immediate family over 18 years of age."*

Student passes:

- "1. Since the education program is tax supported, non-residents may register for classes. ...*
- 3. Non-resident CO-3 student passes are issued for use while attending classes only and are not for use at any other time or at any other CO-2 facilities. Non- resident students may arrive at the facility no more than 15 minutes prior to the class's official start time and must vacate the facility no more than 15 minutes after the instructor dismisses the class.*
- 4. Passes issued to CO-3 students are good for only the registered student. Guests may not accompany the student into the community for any reason. The only exception is those driving student to class as approved by CO-4.*
- 5. The expiration date on the student pass is the last day of the semester.*
- 6. The expiration date on the instructor's pass is the Friday following the last day of the semester. ...*
- 7. CO-3 education classes may be held at all clubhouses except Clubhouses Six and Seven."*  
[Emphasis added.]

Tours, Filming and/or Photography Access:

*"The ORG Foundation Board of Directors and its Staff are eager to promote the community through tours and publicity. It should be noted that **since this is a private gated community and residents expect a certain level of security, freedom to use their facilities without interruption, and personal privacy in their homes that the Community affords them**, certain guidelines are required for community access. This policy does not apply to media coverage of "breaking" news items covered by media such as newspapers or television; nor does this policy address requests made by residents personally for media access to the Community."* [Emphasis added.]

To verify public use of facilities, we reviewed usage data for each common facility for the year 20XX. The following table summarizes visitations by each facility:

Recreation Facilities	Residents	Guests	Students	Unknown	Total	Guest %	Student %	Unknown %
Clubhouse I								
Clubhouse II								
Clubhouse III								
Clubhouse IV								
Clubhouse V								
Clubhouse VI								
Clubhouse VII								

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Clubhouse II Pool								
Community Center								
Golf Course 27-Hole								
Golf Course 3 Par								
Library								
Paddle Tennis								
Pool #1								
Stables								
Swimming Pool IV								
Swimming Pool V								
Swimming Pool VI								
Tennis Courts								
<b>Total</b>								
possible non-members								

Students are restricted to facilities in which their registered chasses are held, and are not allowed to "hang around" any facility. There is no evidence that visitors designated as "Unknown" are non-members. Nevertheless, treating unknown visitors as general public visitors, ORG had % general public usage of its common facilities in the year 20XX.

Clubhouse Seven, Community Center, Library and Stables are located outside of the gated area and purportedly open to the general public. However, Clubhouse Seven had no student or unknown visitor. Community Center, Library and Stables had 4,615 or %, 10,672 or % and 1,947 or % of unknown visitors respectively. Unknown visitors of these three facilities represented % of the total visits.

ORG provides bus service to its residents and describes its bus service as providing "*transportation to nearby banking and restaurant facilities, shopping centers, houses of worship, and some of the most modern and complete medical and hospital facilities, all located in close proximity to the community. Rides are free to residents who show their resident ID Card to the driver.*" The first item listed on Bus Rider Rules & Regulations is identification and it states "*All bus users **MUST** show their resident ID Card or Access Pass to the driver, or confirm that they are in the company of a resident when entering the bus. **Since the bus service automatically permits gate entry to passengers, there are no exceptions to this requirement.***"

ORG allows participants of ORG Memorial Half Marathon & 5K event to run through its gated areas. This event takes place on Memorial Day of each year. Both course routes enter and exist through Gate 2. However, visitor records for Special Events/Arts & Crafts Shows for May 31, 20XX, the day of the marathon in 20XX, indicates a total of zero visitors.

The Golf Classic to Benefit CO-4 Memorial was held on October 18, 20XX. However, the visitor data indicates that no one played golf on this day. CO-5 held a seminar on October 1, 20XX in the auditorium of Clubhouse Three. The visitor data indicates that 600 residents participated in this event. The 20XX Grandparents and Grandkids Fun Day was held on July 28, 20XX in Clubhouse Two. The visitor data indicates that 340 residents and three guests participated in this event.



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## LAW

### Internal Revenue Code

**IRC §501(c)(4)(A):** *"Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."*

**IRC §501(a):** *"Exemption From Taxation. — An organization described in subsection (c) or (d) or §401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under §502 or §503."*

### Federal Tax Regulations ("The Regulations")

**The Regulation §1.501(c)(4) Civic organizations and local associations of employees** (The following does not reflect changes made to the Code by P.L. 99-514, P.L. 100-203, P.L. 100-647, P.L. 101-73 or P.L. 104-168.):

#### *"(a) Civic organizations*

*(1) In general. — A civic league or organization may be exempt as an organization described in section 501(c)(4) if:*

- (i) It is not organized or operated for profit; and*
- (ii) It is operated exclusively for the promotion of social welfare.*

#### *(2) Promotion of social welfare*

*(i) In general. — An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of §1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of §1.501(c)(3)-1.*

*(ii) Political or social activities. — The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit. ..."*

### Court Cases

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**Commissioner v. Lake Forest, Inc.**, 305 F. 2d 814 (1962): This case involved a nonprofit membership housing cooperative that provided low cost housing to its members. In denying exemption, the court stated that the organization was not organized exclusively for the promotion of social welfare. The court found that although its activities were available to all citizens eligible for membership, "*its contribution is neither to the public at large nor of a public character.*" The court looked to the benefits provided and not to the number of persons who received benefits through membership. The court compared its decision in *Lake Forest* with that in *Garden Homes Co. v. Commissioner*, 64 F. 2d 593 (7th Cir. 1933), which held that a housing project formed and controlled by the local government qualified for exemption.

**Flat Top Lake Association, Inc. v. U.S.A.**, 868 F.2d 108, 63 A.F.T.R.2d 89-721, 89-1 USTC P 9180 (1989): The Flat Top Lake Association, consisting of owners of property surrounding artificial lake that sought to restrict development to members only, brought civil action seeking judicial determination that it currently was and had been exempt from federal taxation as a social welfare organization. The Court of Appeals held that: (1) organization that operated for exclusive benefit of members did not serve as "community," as that term related to broader concept of social welfare, for purposes of tax exemption, and (2) association that had done everything within its power to create wholly private environment for its members was not "community," within meaning of federal tax exemption, and could not claim tax exemption for benefiting itself.

**Indian Lake Property Owners Association v. Director of Revenue**, 813 S.W.2d 305 (1991): The Supreme Court of Missouri held that: (1) homeowners' association that enforced subdivision covenants, maintained subdivision roads, and provided security and trash collection services to residences within subdivision was not "civic organization" entitled to sales and use tax exemption, and (2) to qualify as "civic organization," organization's purposes and functions must be concerned with and relate to citizenry at large. Further, the presiding judge referenced *Flat Top Lake* stating, "*Clearly Congress believed that an organization cannot serve social welfare if it denies its benefits to the general public. Implicitly Congress recognized that a true 'community' functions within a broader national fabric. Service to such a community thereby furthers the national interest by expanding potential, by opening opportunities to all citizens who may find themselves within the bounds of that particular community.*" Exemption denied (affirmed).

**Lake Petersburg Association v. C.I.R.**, 33 T.C.M. (CCH) 259, T.C.M. (P-H) P 74,055, 1974 PH TC Memo 74,055 (1974): Lake Petersburg Association was an idea presented by the Petersburg Chamber of Commerce to help stimulate the economy in the surrounding area. A group of businessmen contributed capital and acquired capital from other sources such as the City, the Chamber and two banks, to obtain funding to purchase property and develop it. They formed an association, which required prospective owners to become dues-paying members. The dues helped finance the development of the lake and recreational facilities on said property. Use of the assets was limited to members and their guests. The Association's basis for their argument is that the organization was created to stimulate the economy and make it a better place to live, thereby fulfilling the requirement of a social welfare organization under §501(c)(4). The respondent argued that it was operated primarily for the benefit of its members and therefore did not qualify. The Court found that

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regardless of the original intent, the actual benefit went to the members and any economic benefits to the Petersburg citizens were "indirect and remote." Exemption was denied.

**Rancho Santa Fe Association v. U.S.A.**, 54 A.F.T.R. 2d 84-5518 (1984): Rancho Santa Fe Association's request for affirmation of their exempt status as a §501(c)(4) organization was granted by the Court. The facts are that Rancho Santa Fe Association consists of 6,100 acres of property, 600 acres of which is owned by the Association and the rest by members who are property owners. Of the 600 acres owned by the Association, 465 acres are dedicated to parkland and open space, playgrounds, athletic fields, a public parking lot, a community clubhouse, and hiking and bridle trails, which are all open to the public. The remaining 135 acres comprise an 18-hole golf course and eight tennis courts which are only available to members. The Association oversees the governance of the property, furnishes private security protection, and functions as a liaison between the community and the Board of Supervisors on issues which require the participation of larger governmental entities, such as maintenance of the rights-of-way and the sanitation system. Finally, the Association serves the community in loaning out its facilities free of charge to various public service organizations as well as to the schools. The court decided that "*It performs the functions of a governmental entity and brings about civic betterments and social improvements that would be sorely missed by the Rancho Santa Fe community should they be lost or curtailed.*" Exemption was granted.

## Revenue Rulings

**Revenue Ruling (Rev. Rul.) 72-102, 1972-1 CB 149:** The organization is a membership organization that was formed by a developer and is operated to administer and enforce covenants for preserving the architecture and appearance of a housing development, and to own and maintain common green areas, streets, and sidewalks for the use of all development residents. Its activities are for the common benefit of the whole development rather than for individual residents or the developer.

**Rev. Rul. 74-99, 1974-1 C.B. 131**, modified Rev. Rul. 72-102, to make clear that a homeowners' association of the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under §501(c)(4) of the Code, satisfy the following requirements:

- (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof;
- (2) It must not conduct activities directed to the exterior maintenance of private residences; and
- (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

**Rev. Rul. 80-63, 1980-1 CB 116:** This Rev. Rul. clarifies Rev. Rul. 74-99, by answering specific questions. Relevant portion of this Revenue Ruling has been reproduced below:

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*Question 1: Does Rev. Rul. 74-99 contemplate that the term "community" for purposes of section 501(c)(4) of the Code embraces a minimum area or a certain number of homeowners?*

*Answer 1: No. Rev. Rul. 74-99 states that it was not possible to formulate a precise definition of the term "community". The ruling merely indicates what the term is generally understood to mean. Whether a particular homeowners' association meets the requirements of conferring benefit on a community must be determined according to the facts and circumstances of the individual case. Thus, although the area represented by an association may not be a community within the meaning of that term as contemplated by Rev. Rul. 74-99, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a community.*

*Question 2: May a homeowners' association, which represents an area that is not a community, qualify for exemption under section 501(c)(4) of the Code if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to members of the association?*

*Answer 2: No. Rev. Rul. 74-99 points out that the use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association. For purposes of Rev. Rul. 74-99, recreational facilities are included in the definition of "common areas".*

*Question 3: Can a homeowners' association establish a separate organization to own and maintain recreational facilities and restrict their use to members of the association?*

*Answer 3: Yes. An affiliated recreational organization that is operated totally separate from the homeowners' association may be exempt. See Rev. Rul. 69-281, 1969-1 C.B. 155, which holds that a social club providing exclusive and automatic membership to homeowners in a housing development, with no part of its earnings inuring to the benefit of any member, may qualify for exemption under section 501(c)(7) of the Code.*

### **GOVERNMENT POSITION**

Although the areas owned by ORG and its residents represent % of the city of City, ORG strategically built gates around the areas owned by it and its member-residents, so that substantially all of the remaining % of the city plus all general public traffics are outside of the gated areas. This % of the city encompasses open spaces, commercial buildings, commercial businesses, churches, public roads and its community center that handles public access. Agent's visits to ORG were at this

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Community Center that did not require passing through any of the 16 gates. For a tour of the facility, the assistant treasurer accompanied Agent and provided access to each facility with her identification.

ORG provides quasi-police services for its residents. This quasi-police patrols the areas, answers emergency calls, issues parking and speeding tickets and impose fines on residents. Speeding tickets issued by these patrols don't effect a resident's driving record until violations become egregious. The quasi-police services are not available to the remaining % of the City that are outside of the gated areas.

ORG takes pride in providing bus services to its residents and claims that it is providing community service. The flip side of this matter is that ORG prevents non-residents from entering the gated areas by riding buses that run through the gated areas. This bus service doesn't provide transportation to the community outside of the gates.

Although the Library is located outside of the gated area, records indicate that the Library doesn't provide services to non-members. The Library doesn't even have a fee schedule to impose on non-members when they fail to return borrowed materials.

Overall, public visits to all facilities represented % of total visits in 20XX. Other records indicate that the visitation data was incorrect and/or incomplete. It is not clear as to how much reliance we can place on visitation data. Nevertheless, one matter is certain: ORG strictly controls non-residents entering the gated areas to utilize facilities or participate in events. Even employees of ORG are prohibited from utilizing facilities or participating in events, unless there is an expressed permission.

In order for an entity to be exempt under the Code §501(c)(4), it must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof. First, the size of ORG isn't equivalent to the city of City. Second, the activities and services ORG provides are not even available to the remaining % of the city that are outside of the gated areas, let along the general public at large.

Rev. Rul. 80-63 states "*if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a community.*" We determine that ORG controls and restricts the use of its facilities for the enjoyment of it resident members.

The court cases *Flat Top Lake Association, Inc. v. U.S.A.* and *Indian Lake Property Owners Association v. Director of Revenue* state that an organization that operated for exclusive benefit of members and did everything within its power to create wholly private environment for its members was not serving a community within meaning of federal tax exemption, and could not claim tax exemption for benefiting itself.

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### **TAXPAYER POSITION**

ORG considers that its size is large enough to meet the requirement of a community and should not be required to expand the general public's access to its common areas. Nevertheless, ORG chooses to accept the revocation of its exempt status, effective January 1, 20XX.

### **CONCLUSION**

ORG does not constitute a community within the meaning of Revenue Ruling 80-63.

ORG does not continue to qualify as a social welfare organization described in Internal Revenue Code §501(c)(4) and the regulations thereunder.  
Therefore, revocation of exempt status is proposed, effective January 1, 20XX.

ORG is required to file Forms 1120-H or 1120, *U.S. Corporation Income Tax Return*, for the years ending December 31, 20XX and after.